No. 10933

IN THE

United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT

ETHEL STRICKLAND ROGAN, as Executrix of the Last Will and Testament of Nat Rogan, deceased,

Appellant,

vs.

FERNAND MERTENS, also known as Fernand Gravet and VICTORINE CATHERINE RENOURD MERTENS,

Appellees.

Upon Appeal from the District Court of the United States for the Southern District of California.

BRIEF FOR THE APPELLANT.

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TOPICAL INDEX.

TABLE OF AUTHORITIES CITED.

CASES. PAGE

STATUTES. PAGE

MISCELLANEOUS.

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BRIEF FOR THE APPELLANT.

Opinion Below.

The opinion of the District Court [R. 19-21] is reported at 56 F. Supp. 450.

Jurisdiction.

This is a suit to recover income taxes for the calendar year 1938 in the total amount of $18,399.30, or the sum of $9,199.65 by each taxpayer, together with interest thereon as provided by law. On June 21, 1938, taxpayer, Victorine Catherine Renourd Mertens, paid to the Collector the sum of $3,245.92. [R. 24.] On September 7, 1938, taxpayer, Fernand Mertens, paid to the Collector the amount of $19,649.39 on his own behalf, and the amount of $17,423.88 as the balance due on behalf of his wife,

Victorine Catherine Renourd Mertens. [R. 27.] The above amounts, together with the sum of $1,020.41 previously withheld from plaintiff Fernand Mertens' income aggregated a tax payment in the sum of $20,669.80 by each taxpayer respectively, for the calendar year 1938. [R. 27.] On March 5, 1940, each taxpayer filed a claim for the refund of $9,199.65. [R. 28.] On July 11, 1941, by letters addressed to each of the taxpayers, the Commissioner gave official notice of the rejection of the claims. [R. 29.] Prior to June 30, 1943, the taxpayers instituted an action in the District Court for the recovery of $18,-399.30, with interest, against Nat Rogan, he being then the duly appointed, qualified and Acting Collector of Internal Revenue for the Sixth Collection District, California. [R. 3, 22-23.] On August 8, 1943, Nat Rogan died, and on October 8, 1943, Ethel Strickland Rogan, his widow, was by order of the Superior Court of the State of California, in and for the County of San Diego, duly appointed executrix of the last will and testament of Nat Rogan, and on that date she duly qualified as such executrix. [R. 2, 23.] An amended complaint was filed herein on October 28, 1943, in which the aforesaid executrix, as executrix of the deceased Collector, was duly substituted and served as defendant herein. [R. 2-9.] On May 29, 1944, the District Court entered judgment against appellant allowing the claims of taxpayers in the sum of $8,-802.40, respectively, together with interest thereon. [R. 32-33.] Notice of appeal was filed on August 28, 1944. [R. 34.] Jurisdiction of this Court is invoked under Section 128(a) of the Judicial Code, as amended by the Act of February 13, 1925. Jurisdiction was conferred on the District Court by Section 24, Fifth, of the Judicial Code.

Question Presented.

Whether the amount paid or advanced by taxpayer-husband's employer for taxpayers as federal income tax for 1938 was received as income by taxpayers in 1938 and therefore constituted taxable income for that year, or whether the transaction constituted a loan.

Statutes Involved.

The applicable statutes are printed in the Appendix, *infra.*

Statement.

The pertinent facts, taken from the facts found by the District Court [R. 22-29], the stipulation of the parties [R. 40-44], and from exhibits furnished on behalf of taxpayers at the trial [R. 55-62, 90-117, 230-233] may be stated as follows:

Fernand Mertens, also known as Fernand Gravet, and Victorine Catherine Renourd Mertens are husband and wife, married under the law of France, and were resident aliens of the United States during all of 1938, residing in Los Angeles County, California. [R. 22.] During 1938 and prior to July 29th thereof, Fernand Mertens rendered services as an actor for Warner Brothers Pictures, Inc., at Los Angeles, California, and was paid therefor the sum of $10,204.09, which item of gross income is not in dispute. [R. 23.] Prior thereto, on May 6, 1936, Mertens had entered into a written contract of employment with one Mervyn LeRoy whereby he [Mertens] agreed to render certain services as actor at a stated salary. [R. 230.] By the terms of this contract the employer agreed "to pay all taxes which Artist may be assessed in the

United States, but not his taxes in France, and only for such sums which Artist derives from his employment throught Employer." [R. 231.] This contract was subsequently assigned to Loew's, Incorporated (hereinafter designated Loew's), subject to the restriction that by its [Loew's] acceptance of the same, it assumed no liability under the contract except as arose subsequently to April 15, 1938, in connection with the photoplay entitled "The Great Waltz." [R. 56.] By the terms of this agreement, Loew's agreed to pay "all taxes which may lawfully be assessed against me [Mertens] in the United States", but only to the extent that they were based upon sums derived by him from services connected with the photoplay "The Great Waltz." [R. 25, 60.] The contract further provided that both parties thereto should use every effort "to the end that said taxes will be paid by September 10, 1938." [R. 60.]

In accordance with the terms of this agreement, Loew's paid Fernand Mertens compensation for his services in the total sum of $120,000 during 1938, prior to September 14, of that year, exclusive of any amounts which may have been paid on account of taxes. [R. 25, 42.] All of the income received by taxpayers was community property. [R. 24.]

On June 21, 1938, Victorine Catherine Renourd Mertens, desiring to go to France, went to the office of Collector of Internal Revenue, Nat Rogan, at Los Angeles, for the purpose of obtaining a certificate of compliance with the internal revenue laws. She was required to file on that date, as a resident alien, a departing alien income tax return on Treasury Department Form 1040-C, for the period beginning January 1, 1938, and ending June 30,

1938, and reported thereon one-half of the then assumed earnings of the husband received during such period to June 30, 1938. The tentative tax computed thereon was the sum of $3,245.92 which Mrs. Mertens paid to the Collector, after which, on June 30, 1938, she departed from the United States for Paris, France. [R. 24.] The Court found that the funds with which this tax was paid were loaned by Loew's Incorporated, and duly recorded on the latter's books as a loan.[1] [R. 24.]

Thereafter, on or before August 30, 1938, Fernand Mertens advised the Collector that he intended to depart the United States for France on or about September 14, 1938, and desired to obtain the necessary certificate of compliance with the internal revenue laws. Before issuing the certificate, the Collector recomputed the tentative federal income tax liability of Mrs. Mertens in respect to one-half of the community property income of taxpayers earned between January 1, 1938, and September 14, 1938, inclusive, and estimated her tax liability for that period to be $20,669.80. A similar computation of tentative tax liability was made in the amount of $20,669.80 by the Collector for Fernand Mertens with respect to his half of the community. In making these computations the Collector included in taxpayers' community property incomes, the total sum of $40,017.41 as his estimate of the amount of tax to be payable by Loew's, on the ground that it would be income "constructively received" from Loew's, in 1938. [R. 24-25.]

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[1]The finding that these funds were loaned by Loew's is claimed by appellant to be erroneous as being without substantial evidence to support it, and as being a conclusion of law not supported by the findings of fact. See Argument, *infra*.

The sum of $40,017.41 so included by the Collector as part of taxpayers' income for the year 1938 was algebraically computed and built up by pyramiding taxes under the Collector's theory that such amount represented the liability of Loew's under the agreement of July 29, 1938, above referred to. [R. 25.]

The court further found that when Mertens and Loew's, on or before August 30, 1938, were advised by the Collector that the aggregate taxes would be computed and payment would be demanded in an amount in excess of $40,000, based upon the Collector's insistence that an amount of $40,017.41 would have to be added to income before any certificate of compliance would be issued, the parties to the agreement of July 29, 1938, promptly substituted a new agreement whereby it was agreed that Loew's should advance the amount which was going to be demanded by the Collector as a loan, to be adjusted later when the full tax liability had actually been determined and ascertained; and that this could not be done until after the taxable year had ended.[2] [R. 26.]

The court further found that on September 7, 1938, the Collector prepared on Treasury Department Forms 1040-C, departing alien income tax returns, one for each taxpayer, for the period from January 1, 1938, to September, 1938, and included therein, in addition to the sum of $40,017.41 estimated to be an amount "constructively received" from Loew's, all income derived by taxpayers from all sources within and without the United States during

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[2]These findings are challenged by appellant as not justifying the conclusion of a loan, under the law applicable thereto. See Argument, *infra*.

the period from January 1, 1938, through September 14, 1938, resulting in an aggregate claimed net income of $154,850.21, of which one-half or $77,425.10 was included in each return; that the total tax liability shown on each return was $20,669.80; that the total tax for both parties was shown as $41,339.60, of which $301.78 represented the total tax attributable to taxpayers' French community property incomes; and that after deducting $1,020.41, representing tax withheld and paid by Warner Brothers, there remained a combined tax balance of $40,017.41,[3] which was also the exact amount which the Collector included in taxpayers' community incomes as "constructively received" from Loew's, Inc. [R. 26-27.]

The court found that Fernand Mertens executed and filed with the Collector these returns both for himself, and under a power of attorney, for his wife; that on the date of such execution and filing, namely, September 7, 1938, the amounts of $19,649.39 and $17,423.88 were paid to the Collector by taxpayers, which amounts together with the amounts previously shown to have been paid or withheld aggregated $20,669.80 each for the respective taxpayers; that thereupon certificates of compliance with the internal revenue laws were issued to them as of September 7, 1938, and that Fernand Mertens thereafter, on or about September 15, 1938, left the United States for France, without surrendering his status as a resident alien of the United States. [R. 27.] The taxpayers were on the cash receipts and disbursements basis of accounting and filed their returns on such basis. [R. 27, 43.]

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[3]It should be noted that in arriving at the figure of $40,017.41, the tax on the French community property incomes in the amount of $301.78 was also deducted from the original total tax of $41,339.60.

The court found that taxpayers did not file returns for the entire calendar year of 1938 on any printed income tax return forms supplied by the Treasury Department. [R. 28.] It was stipulated between the parties [R. 44] that other than the three departing alien income tax returns executed by taxpayers in June and September, 1938, no income tax return or returns on printed income return forms supplied by the Treasury Department, either original, supplemental, or amendatory, reporting income of either of the taxpayers for the year 1938, or for any part thereof, was or were ever filed with the Treasury Department by the taxpayers, or either of them, prior to the commencement of this action. The court found [R. 28] that schedules were attached to claims for refund subsequently filed which disclosed the total of taxpayers' incomes for the entire year, together with deductions, showing aggregate net incomes slightly less than those shown in the department alien returns of September 7, 1938.

On March 5, 1940, taxpayers each filed a claim for the refund of $9,199.65 or such amount as is legally refundable, the ground set forth in the claims being that the Collector had erroneously added to their combined community incomes for the period January 1, 1938, through September 14, 1938, the amount of $40,017.41 as income constructively received in 1938. [R. 28, 90-101, 103-115.] On December 4, 1940, taxpayers filed through their duly authorized representative identical letters of protest upon being advised that an examination of their tax returns for 1938 in connection with their claims for refund did not in the opinion of the Internal Revenue Agent in Charge at Los Angeles disclose any grounds for reduction of their tax liabilities. [R. 29.] The refund claims were rejected by letters dated July 11, 1941, to each taxpayer. [R. 29.]

Additional facts found by the Court below were that the correct amount of tax on taxpayers' community income of $120,000 and all other income from all other sources after proper deductions was and is $11,876.40 for each taxpayer for the period in question [R. 25];[4] that Loew's Incorporated advanced the amount of $37,073.27 as a loan to taxpayers and entered it on its books accordingly [R. 27-28, 29];[5] and that the loan arrangement was not a mere bookkeeping matter resorted to with the view of avoiding tax but was a bona fide new arrangement brought on by the erroneous demand of the Collector of Internal Revenue. [R. 28.][6]

As conclusions of law from the above findings of fact, the Court concluded that the amount of $40,017.41 was erroneously and unlawfully included in taxpayers' 1938 incomes with respect to which the taxes involved were paid; that the substituted agreement with Loew's Incorporated made on or about August 30, 1938, pursuant to which the loan was made by Loew's was a lawful and binding agreement between the parties and its obligation

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[4]This finding is challenged as being without support in the evidence, and as actually constituting a conclusion of law erroneously drawn from the facts found and stipulated to. See Argument, *infra.*

[5]It is appellant's contention that this constitutes a conclusion of law and is without support in the findings of fact and the evidence. See Argument, *infra.*

[6]This is claimed to be error for the reasons heretofore stated.

remains in full force and effect, and that it operated to modify any prior agreements or understandings between the parties; and that each taxpayer herein overpaid his and her respective income taxes for the period from January 1 to September 14, 1938, in the amount of $8,802.40, and hence they were entitled to judgment against collector in that amount, respectively, with interest, plus costs. [R. 30-31.]

Statements of Points to Be Urged.

The District Court erred:

1. In holding that the amount of appellees' 1938 income tax paid by appellee-husband's employer in June and September of such year did not constitute the taxable income of appellees.

2. In holding that the amount of such income tax paid by the appellee-husband's employer constituted a loan to the husband.

3. In holding that the amount of such tax payments did not constitute realized income in the taxable period when such taxes were due and payable.

4. In that Findings 12 and 14 and Conclusion 4 are not supported by substantial evidence.

5. In that Conclusions 3, 4, 5, 6, and 7 are contrary to the law, and are not supported by the findings or by substantial evidence.

6. In the alternative, (a) in impliedly holding that the appellee-husband became contractually and unconditionally

obligated to pay to his employer any amount certain by virtue of such tax payments; (b) in impliedly holding that the appellee-husband's liability, if any, to pay all or any part of such monies to his employer was not contingent; (c) in impliedly holding that such taxes were not so paid by the employer under a "claim of right" made by appellee-husband and (d) in impliedly holding that the appellees did not have the use, enjoyment and benefits of such tax payments at the time they were made.

7. In the alternative in holding that the complaint states a claim upon which relief can be legally granted the appellee-wife, and in ordering a judgment in favor of the appellee-wife.

8. In that the findings do not support the judgment.

9. In that the evidence does not support the findings.

Summary of Argument.

The law is well established that a taxpayer's income tax in a given taxable period must be computed upon all the taxable income received by him, including that portion which consists of his income taxes paid or advanced for him by a third person for a consideration. This is true, even though there may be a conditional liability on the part of the taxpayer subsequently to repay some or all thereof. Where the original payment on the taxpayer's behalf is made pursuant to a recognized liability on the part of the payor to pay such taxes, the payment constitutes taxable income to the taxpayer in the year in which it is made, re-

gardless of a subsequent contingent liability of repayment.

Such a situation is presented by the evidence and the stipulated facts in the case at bar. The evidence is undisputed that taxpayer's employer originally agreed to pay all of his taxes lawfully assessed arising out of a particular contract within the United States, and to do so within the taxable period. The liability to pay the employee's taxes for the taxable year 1938, insofar as they were "lawfully assessed," was at all times recognized by the employer; the employer actually advanced the taxes demanded by the Collector for 1938 as a condition to the procuring of a certificate of compliance in order to enable the employee and his wife to leave the United States; and it was understood between employer and employee that if any part thereof were subsequently declared "unlawful," the employee was to repay such "unlawfully assessed" portion. The so-called "new" agreement did not alter the rights of the respective parties under the original contract. The District Court's conclusion that a loan was made is contrary to its own findings and the undisputed facts.

Even if it be conceded that some small portion of the amount advanced by the employer herein was in excess of the amount such employer was obligated to pay, such excess would only constitute an overpayment, repayable by the employee. This would not alter the fact that the payment was income to the taxpayer when made.

ARGUMENT.

The Amount of the Taxpayers' Income Taxes Paid by Taxpayer-Husband's Employer in 1938 Constituted Income to the Taxpayers in That Year.

It is well established that a taxpayer's gross income upon which his tax is based must be computed to include all taxable income received by him, including that portion which consists of his income taxes paid by a third person for a consideration. This rule has been applied by the Supreme Court to taxes paid by a lessee for or on behalf of his lessor [*United States v. Boston & M. R. Co.*, 279 U. S. 732, 734; *United States v. Joliet & Chicago R. Co.*, 315 U. S. 44, 47; cf. *United States v. Mahoning Coal R. R. Co.*, 51 F. (2d) 208 (C. C. A. 6th)); and to an employee's taxes paid by his employer (*Old Colony Tr. Co. v. Commissioner*, 279 U. S. 716, 729; 2 Mertens, Law of Federal Income Taxation, Sec. 11.28).

Such tax payments constitute income when paid, even though the obligation is contingent upon the taxes being lawfully assessed, and even though a suit attacking the inclusion of the tax in gross income may be contemplated, and may not be finally decided until a later year, and the third party's obligation to pay the tax may be contingent upon such litigation. (*Commissioner v. Terre Haute Elec. Co.*, 67 F. (2d) 697 (C. C. A. 7th), certiorari denied 292 U. S. 624).[7]

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[7]In the *Terre Haute* case, *supra*, the lessee's contract to pay lessor's taxes "lawfully assessed" contained a proviso that lessee might, if it so desired, after giving lessor notice, resist by legal proceeding the payment of any tax, in which case the duty to pay would not arise until 30 days after final adjudication thereof by a court of competent jurisdiction. The court held that the additional taxes for the years 1922 and 1923, occasioned by the rejection of lessor's asserted deduction for depreciation were taxable income for the years 1922 and 1923, despite the fact of pending litigation concerning the validity of the tax, because of the lessee's obligation to pay them.

The contracts between Mertens and LeRoy, and between Mertens and Loew's Incorporated, come clearly within the above decisions. The contract between Mertens and LeRoy, dated May 6, 1936, provided that "Employer * * * agrees to pay all taxes which Artist may be assessed in the United States. but not his taxes in France, and only for such sums which Artist derives from his employment through Employer." [R. 231.] This contract was assigned by LeRoy to Loew's Incorporated on July 29, 1938, by two contracts of that date, the terms of the first of which provided that "We [Loew's] have accepted the same with the restriction that by our acceptance of the same we are assuming no liability under said contract except such liability thereunder as has arisen subsequent to April 15, 1938 in connection with the photoplay now entitled "The Great Waltz"," [R. 56]; and the terms of the second of which provided that "You [Loew's] agree to pay all taxes which may lawfully be assessed against me in the United States, but only to the extent that such taxes are based upon sums derived by me from my services in connection with said photoplay now entitled "The Great Waltz". [R. 60.] This second contract likewise contained the provision that both Mertens and Loew's were to "use every effort to the end that said taxes *will be paid by September 10, 1938* and to the end that I [Mertens] shall be free to leave the United States on that date * * *." [R. 60.][8] (Italics supplied.)

Two facts are clear from the July, 1938, agreement: (1) Loew's agreed to pay Mertens' taxes lawfully assessed arising out of his contract with Loew's in connection with

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[8]These two contracts of July, 1938, will hereafter be referred to as one contract.

his performance of "The Great Waltz," and (2) it was definitely understood that this was to be done prior to Mr. Mertens' proposed departure from the United States in September of 1938.

The alleged occasion for the so-called "new agreement" of August 30, 1938, between Mertens and Loew's upon which the court predicated its finding of a "loan" [R. 26] was the demand of the Collector that all income taxes of the Mertens for 1938 should be paid prior to their departure for Europe. The court below found that the Collector's demand was "erroneous" [R. 28] and that it was therefore understood between the parties that the money should be advanced by Loew's Incorporated as a loan, "to be adjusted later on when the full tax liability had actually been determined and ascertained." [R. 26.]

The finding of a "loan," to the extent that it was a finding of fact at all, is not supported by the record: (1) The demand of the Collector upon which it is allegedly predicated, was not erroneous; (2) the very finding itself, as qualified, does not justify the conclusion that the money advanced was "loaned"; and (3) from the undisputed evidence it is clear that neither party to the "new" contract actually contemplated a loan.

With respect to the Collector's demand, it should be noted that the Collector, in requiring that Mertens and his wife pay their income taxes for the taxable period in question prior to the issuance of a certificate of compliance which would enable them to leave the United States, was not acting arbitrarily, but was required to exact such taxes by the provisions of the Revenue Act of 1938, Section 146, in view of the status of the Mertens as aliens.[9] By the

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[9]See Appendix *infra,* as to the provisions of this statute.

provisions of this statute, the Collector was not only authorized and directed, but required, in situations where an alien was about to depart from the United States prior to the expiration of the taxable year without leaving any security for the payment of his taxes as finally computed when the taxable year had expired, to declare the taxable period immediately terminated, and that the taxes thereupon were immediately payable. The court's finding, therefore, that the tax liability could not be determined "until after the taxable year had ended" [R. 26], if intended to include the whole of the year 1938, was erroneous as a matter of law. No bond was ever furnished or offered, by or on behalf of the Mertens, to avoid or suspend the application of the statute [R. 206]; and no further return was ever filed by either taxpayer to amend the returns filed on or before the date of their respective departures [R. 28, 44], so that the returns as filed in September of 1938, on behalf of Mrs. Mertens and Mr. Mertens respectively, were actually the final returns made for the taxable year 1938. The taxable year in question, therefore, actually ended in September of 1938. Furthermore, the obligation of Loew's to pay these taxes for Mertens prior to the date of departure was, as has already been shown, clearly recognized by Loew's when the original contract was entered into with Mr. Mertens in July of 1938, whereby it was specifically provided that every effort should be made that the taxes should be paid "by September 10, 1938." [R. 60.] There was obviously, therefore, no error on the part of the Collector in making his demand prior to Mertens' departure. Nor was such demand a surprise to either the taxpayer or his employer.

The District Court's findings and the evidence definitely establish that the so-called "new agreement" of August 30,

1938, did not constitute a loan in the legal sense. No definite promise to return the amount loaned, or its equivalent, was ever made (*In re Grand Union Co.,* 219 Fed. 353, 356 (C. C. A. 2d); *Northern Mining Corp. v. Trunz,* 124 F. (2d) 14, 16 (C. C. A. 9th) certiorari denied 316 U. S. 664; *United States v. Mahoning Coal R. R. Co., supra; Embola v. Tuppela,* 127 Wash. 285, 220 Pac. 789; *Teed v. Parsons,* 202 Ill. 455, 66 N. E. 1044; *People ex rel. Talcott, Inc. v. Goldfogle,* 213 A. D. 719, 211 N. Y. S. 122; *Marshall v. Commissioner,* 32 B. T. A. 956; *Kinnear v. Commissioner,* 36 B. T. A. 153, 95 F. (2d) 997 (C. C. A. 9th); 1 Mertens, Law of Federal Income Taxation, Sec. 5.24; *Perrin v. Carbone,* 1 Cal. App. 295; California Civil Code, Sec. 1912 (Appendix, *infra*)); and the implied obligation to repay any overpayment which may have been advanced certainly was not an unconditional and non-contingent obligation to repay the funds advanced. Such unconditional obligation to repay the amount of a loan is an indispensable characteristic of its very existence in the first instance. *In re Grand Union Co., supra; Northern Mining Corp. v. Trunz, supra; United States v. Mahoning Coal R. R. Co., supra; Jennings & Co. v. Commissioner,* 59 F. (2d) 32, 35 (C. C. A. 9th); *Mitchell v. Commissioner,* 89 F. (2d) 873, 876 (C. C. A. 2d), certiorari denied 302 U. S. 723; *Jacobs v. Hoey,* 136 F. (2d) 954, 956 (C. C. A. 2d); *Barker v. Magruder,* 95 F. (2d) 122 (App. D. C.); *Boston Elevated Ry. Co. v. Commissioner,* 131 F. (2d) 161 (C. C. A. 1st), certiorari denied 318 U. S. 760; *Texas & Pacific R. Co. v. United States,* 286 U. S. 285.

Furthermore, the obligation for the return of any overpayment existed on the part of the Mertens in any event, with respect to the advance made by Loew's, under the

previously existing agreement of July, 1938, so the alleged "new agreement" in no way altered the relationship of the parties under their first agreement.

With respect to the alleged "loan" for the payment of *Mrs.* Mertens' taxes, it should be noted that the *original* July contract between Loew's and Mertens was not entered into until *after* Mrs. Mertens had already sailed for France [R. 24], *after* her first departing alien income tax return had been filed, and *after* her share of the community income taxes, as first computed, had been paid [R. 63], not to speak of any "new agreement" supplemental thereto. Prior to such payment for Mrs. Mertens (on June 21, 1938) and a full month prior to the date of the original Loew's-Mertens contract (July 29, 1938), there had been some discussion between the accountants and attorneys for Loew's as to "whether Loew's Incorporated had any liability *immediately at that time* for the payment of her [Mrs. Mertens] tax; in other words, whether it could be regarded as an immediate lawful assessment." [Italics supplied, R. 204.] However, in spite of that problem in the minds of the accountants and attorneys, no reference whatsoever was made to any loan when the tax for Mrs. Mertens was paid [R. 138-148, 202-205, 233-235], nor was any discussion had with the Collector regarding such a possibility in June of 1938, since the tax was not included in the computation of her share of the community income at that time. [R. 234-235.] In fact, Mr. White, a witness for taxpayers, who was present at the June payment specifically testified when asked whether the question had been discussed (on the occasion of Mrs. Mertens' tax payment) whether the tax should be paid on that particular payment by Loew's, that "there was no

question but that Loew's was to furnish the money." [R. 234.]

It is true that the record [R. 258] shows an inter-office communication in Loew's files, dated June 27, 1938, reciting that

> *Mr. Craig* [apparently of Loew's staff of attorneys] *decided* that *we* [Loew's] should *treat* the amount of tax paid for Mrs. Gravet as an advance or loan. *We will also treat* the taxes paid for his account when he leaves as a loan *or an advance.* This situation comes about because a supplementary agreement is being entered into with him making this possible, according to Leon Levi" [attorney for Loew's]. (Italics supplied).

Just what such proposed agreement was to be supplementary to is not apparent from the evidence, since the original contract between Mertens and Loew's had not yet been entered into.

However, more than a month after the above payment for Mrs. Mertens had taken place, and after the above book entry had been made, the *original* contracts between Mertens and Loew's were entered into, July 29, 1938, whereby Loew's agreed to pay all taxes which might "lawfully be assessed" against Mertens [R. 25, 60], and to use every effort that the taxes should be paid by September 10, 1938. Nothing whatever was said therein about any loan having been or to be made. The July contract being an assignment [R. 56] of the prior May, 1936, contract whereby Mertens' then employer agreed to pay Mertens' taxes assessed in the United States [R. 231], it would seem clear that the payment made for Mrs. Mertens in June of 1938 was made pursuant to such acknowledged

liability; and the finding that such payment when made in June of 1938 constituted a "loan" pursuant to a "new agreement" made some time subsequently to the contract of July, 1938, is manifestly without support in the evidence.

Furthermore, with respect to the findings regarding the existence of a "loan" as to the balance of the tax payments, the evidence is all in support of the recognition by Loew's of its tax liability on behalf of Mertens, for the correctly assessed taxes, and in refutation of any obligation on the part of Mertens to pay back the amount "loaned."

Mr. Levi [attorney for Loew's] told the Collector of Loew's contention that "Loew's was not required to pay Gravet's taxes *until after they had been finally determined for the full year 1938*" (italics supplied) [R. 155]; and that "they [Loew's] felt that *if it was incorrectly computed* that they had no obligation" (italics supplied) [R. 156]. Mr. White, accountant for Loew's, testified that Mr. Levi had told the revenue agent's office on or about August 25, 1938, that Loew's contended that they did not have to "reimburse him for this tax *until after the tax had become final*" (italics supplied) [R. 180-181]; and that he, Mr. White, had been informed that "Loew's would insist on regarding this as a loan *until the tax was finally determined.*" [Italics supplied, R. 182.]

The above statements reveal only what was in the minds of Loew's and its representatives, with respect to the tax liability. The Mertens were not available at the trial to testify in their own behalf; but when Mr. Mertens' testimony was presented through other witnesses, it clearly revealed that regardless of what the transaction might be

called, he understood that Loew's would be liable for his taxes, insofar as they arose out of his employment by Loew's. Mr. White testified [R. 182] that Mr. Gravet told him on September 7, 1938, that he [Gravet] *"had been told that this would not result in any financial detriment to him."* (Italics supplied.) In other words, he [Gravet] did not expect ever to be held liable to repay these taxes so advanced by Loew's. In a letter on the following day, September 8, 1938, Mr. White's employers in reporting to Loew's concerning the above conversation pointed out that [R. 185-186]

> The company's contention that its liability to pay income taxes of Mr. and Mrs. Mertens could not be determined until the close of 1938 was discussed with Mr. Mertens and he informed us that he understood the problem and was quite agreeable that the amounts advanced by the company for the payment of his and Mrs. Mertens' taxes should be considered as a loan *until the amounts of the taxes are finally determined.* (Italics supplied.)

Mr. Levi testified [R. 195-196] that at a studio conference with Mr. Gravet in the early part of September, 1938, he [Levi] "pointed to the provisions of the contract *which state that Loew's will pay taxes lawfully assessed* against him [Gravet] in the United States. I explained to him that it was the position of Loew's Incorporated that there was no liability on their part to make any payment to Mr. Gravet *until such a time as taxes had actually been lawfully assessed against him;"* that Levi had been authorized to lend Mr. Gravet sufficient money to satisfy the Collector's demand, and then they [Loew's] would *"let the question of the ultimate repayment of that loan hinge upon a final determination as to what his actual lawful tax*

liability was, once it was determined what taxes could or should have been lawfully assessed against him." (Italics supplied.) [R. 196.] In reply to this Mr. Mertens "finally did say, after considerable discussion * * * that it was satisfactory to him that the money that Loew's was to advance *should be regarded as a loan and that the ultimate liability would await determination of the final assessment.*" (Italics supplied.) [R. 207.]

In a letter to Mr. Gravet, dated September 8, 1938, after the alleged "new agreement," Loew's stated that [R. 210]:

> *We realize, of course that ultimately we will be required as a part of our contractual liability to you to pay certain of your taxes as set forth in our agreements with you.* * * * As soon as the *exact amount of our liability to you under our agreements* can be determined we will credit your indebtedness with the amount of such liability. (Italics supplied)

The most definite expression of Mertens' understanding with respect to the whole transaction is contained in a letter signed by him, addressed to Loew's and dated September 13, 1938 [R. 308-311], a day or so before he sailed [R. 27], wherein, in answer to Loew's letter to him of September 8, 1938 [R. 209-210] he states the following [R. 308, 309]:

> The tax payment of $40,319.19 made by you represents additional compensation paid to me for my services in connection with the motion picture production, "The Great Waltz." *This money is not a loan and I will not be required to repay any refunds therefrom unless such refunds are actually received by me* * * *. Moreover, I might mention that I have consistently justified this position because we have always

> regarded my operations as being under the original contract with Mervyn LeRoy, and any adjustments between the various studios would have to be worked out not by me but by the studios* * *.

According to Mr. Levi, this letter "should have been destroyed at that time" [R. 331], when, according to him [Levi] he had on the date of Mr. Mertens' departure allegedly secured his oral repudiation of it.

The only effect contemplated by the change in the form of the original agreement is apparent from a letter from Loew's accountants, Price-Waterhouse, to Loew's dated July 27, 1938 [R. 316], wherein it is stated that

> it has been assumed that both Federal and California income taxes would be paid *during 1938.* If payment of the California income tax is delayed until 1939 there may be a saving of from $500 to $2,000 of such tax. Also, if all or part of the Federal income tax can be paid or *construed as having been paid in 1939*, there should be a substantial saving in both Federal and California income taxes. (Italics supplied.)

Mr. Mertens' attitude with respect to the payment of his taxes is also shown even in his consent to the assignment of the LeRoy contract to Loew's dated July 29, 1938 [R. 314], wherein he specifically provides that "nothing herein contained shall be construed to release Mervyn LeRoy from his obligations with respect to the payment of taxes under the provisions of * * * said contract of May 6, 1936." This is merely an additional confirmation of his attitude throughout that he should not be required to pay his taxes in the last analysis, no matter by what term the device was designated by which his taxes were paid for him. This position with respect to the original LeRoy

contract is consistent with his attitude as represented by the testimony of the witnesses at the trial with respect to the Loew's contract, as set forth above, to the effect that he was looking to his employers for the payment of his taxes pursuant to the various agreements entered into with the successive employers, insofar as they were correctly computed and lawfully assessed.

The very refund claims presented on behalf of the Mertens in September of 1940 [R. 90, 103] refer to the liability on the part of Loew's to pay Mertens' taxes, lawfully assessed, and merely question their inclusion as income prior to their definite and accurate computation. The evidence is clear that Mertens definitely understood that in all events his taxes were payable by his employers as correctly computed and lawfully assessed; that Loew's likewise definitely understood and agreed to this obligation, and at no time repudiated it; and that Loew's actually paid the full amount demanded by the Collector on behalf of both taxpayers in 1938, when the taxable period had been terminated by the Collector in accordance with the law applicable to such a situation.

The money advanced under the circumstances presented by this case, therefore, constituted income received by the Mertens in 1938, despite the possibility of a subsequent liability for the repayment of some part thereof. 2 Mertens, Law of Federal Income Taxation, Sec. 17.14; *Saunders v. Commissioner,* 101 F. (2d) 407 (C. C. A. 10th); *Brown v. Helvering,* 291 U. S. 193, 200; *North*

American Oil v. Burnet, 286 U. S. 417; *Commissioner v. Terre Haute Elec. Co., supra; Commissioner v. Lyon,* 97 F. (2d) 70 (C. C. A. 9th); *Griffin v. Smith,* 101 F. (2d) 348 (C. C. A. 7th); *Heiner v. Mellon,* 304 U. S. 271, 275.[10]

The Mertens received the "economic benefit" of having this obligation discharged for them, and were thereby relieved of a liability which they would otherwise have had to discharge themselves. *Boston & Providence Railroad Corp. v. Commissioner,* 23 B. T. A. 1136; *United States v. Hendler,* 303 U. S. 564; *North American Oil v. Burnet, supra; Parkford v. Commissioner,* 133 F. (2d) 249 (C. C. A. 9th), certiorari denied, 319 U. S. 741; 2 Mertens, Law of Federal Income Taxation, Secs. 11.02, 17.20.

The fact that the transaction may have been carried on the books of the employer as a loan is immaterial, since there was no definite unconditional obligation binding the debtor to repay any amount. *Doyle v. Mitchell Bros. Co.,* 247 U. S. 179; *Commissioner v. Union Pac. R. Co.,* 86 F. (2d) 637 (C. C. A. 2d); *Weise v. Commissioner,* 93 F.

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[10]The courts go so far as to hold that even though money may have been advanced for taxes, for another, under a mistake of law that the payer was obligated to pay them, the contingent obligation to repay them will not prevent their inclusion as income in the first instance. See *Boston & Providence Railroad Corp. v. Commissioner,* 23 B.T.A. 1136, 1143-50; *United States v. Mahoning Coal R. R. Co.,* 51 F. 2d 208 (C.C.A. 6th).

Likewise, the fact that the taxpayer-creditor set up in its account books a statement that the funds received from the judgment debtor were subject to be returned in case the judgment should be reversed, and that the money was not to be used by the creditor pending the litigation was held not to change the status of the payment from that of income received in the first instance. *Commissioner v. Alamitos Land Co.,* 112 F. 2d 648 (C.C.A. 9th), certiorari denied, 311 U.S. 679.

(2d) 921 (C. C. A. 8th) cf. *Regensburg v. Commissioner,* 144 F. (2d) 41 (C. C. A. 2d); *Bankers Mortgage Co. v. Commissioner,* 1 T. C. 698, affirmed 141 F. (2d) 357 (C. C. A. 5th); *Gilman v. Commissioner,* 53 F. (2d) 47 (C. C. A. 8th); *City Nat. Bank Bldg. Co. v. Helvering,* 98 F. (2d) 216 (App. D. C.).

Additional alleged findings of the District Court regarding the "correct" amount of the tax, the "proper deductions" that should have been made, the "wrongful" inclusion of the tax paid by Loew's as part of the taxpayers' income, the finding that it was a "valid" loan, and similar expressions add nothing to the findings of fact, since these terms are mere conclusions of law. *Hoper v. Lennen & Mitchell,* 52 F. Supp. 319 (S. D. Cal.); *The Blairmore I,* 10 F. (2d) 35 (C. C. A. 2d); *Hamilton v. Scheets,* 6 F. Supp. 824 (N. D. Ill.). The very existence of a "loan" has been held to be a question of law (*Education Films Corp. v. International Film Serv. Co.,* 129 Misc. 370, 221 N. Y. S. 330, affirmed 222 App. Div. 668, 225 N. Y. S. 818; *Hoard v. Gilbert,* 205 Wis. 557, 238 N. W. 371; *Lobban v. Wierhauser,* 141 S. W. (2d) 384 (Tex. Civ. App.)) under the applicable test that a finding of fact is reached by mere natural reasoning from facts in evidence, whereas a conclusion of law results where the ultimate conclusion can be arrived at only by applying a rule of law to the facts (*Newport News Co. v. Schauffler, Va.,* 303 U. S. 54; *Tesch v. Industrial Comm.,* 200 Wis. 616, 229 N. W. 194; *Levins v. Rovegno,* 71 Cal. 273; *New v. Mutual Benefit H. & A. Ass'n,* 24 Cal. App. (2d) 681.) Tested by the above, the alleged finding regarding the total net income of taxpayers is likewise actually a conclusion of law, since it is based upon the legality of the inclusion or exclusion of certain items; so also, the matter of "proper deductions"

and the "correctness" of a tax. There are no actual findings of fact which support the conclusion of a loan, or of any error on the part of the Collector; and to the extent that these questions may be deemed mixed questions of law and fact, there is no substantial evidence to support such findings. Under these circumstances, the findings are reviewable as errors of law. *King v. Smith,* 110 F. 95, (C. C. A. 9th); *C. C. Mengel & Bro. Co. v. Handy Chocolate Co.,* 10 F. (2d) 293 (C. C. A. 1st) certiorari denied, 271 U. S. 668; *Mermis v. Waldo,* 91 F. (2d) 391 (C. C. A. 10th).

Further, the conclusions being based upon no true findings of fact with respect to a "loan," they are erroneous and will not support the judgment in favor of the taxpayers herein.

On the contrary, we have every element present which renders the payment in the instant case income received by taxpayers in 1938: A recognized obligation on the part of the employer to pay such taxes as were lawfully assessed against the employee, which obligation was never repudiated; an actual payment by the employer of the taxes assessed within the taxable period; taxes lawfully assessed under the law applicable to the peculiar circumstances arising in this case; and no promise of repayment whatsoever on the part of the employee except a possible contingent one to the extent of an overpayment of the taxes as subsequently determined. We submit that no other conclusion can legally be drawn from the facts and the evidence in the case than that the receipt of such payment constituted taxable income to the taxpayers herein in 1938.

Conclusion.

The conclusions of law and judgment of the District Court are erroneous, unsupported by the facts, and contrary to law and the controlling authorities. They should be set aside and vacated by this Court and judgment should be entered for appellant.

Respectfully submitted,

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April, 1945.

APPENDIX.

Revenue Act of 1938, c. 289, 52 Stat. 447:

Sec. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

Sec. 146. CLOSING BY COMMISSIONER OF TAXABLE YEAR.

(a) *Tax in Jeopardy.*—

(1) *Departure of taxpayer or removal of property from United States.*—If the Commissioner finds that a taxpayer designs quickly to depart from the United States or to remove his property therefrom, or to conceal himself or his property therein, or to do any other act tending to prejudice or to render wholly or partly ineffectual proceedings to collect the tax for the taxable year then last past or the taxable year then current unless such proceedings be brought without delay, the Commissioner shall declare the taxable period for such taxpayer immediately

terminated and shall cause notice of such finding and declaration to be given the taxpayer, together with a demand for immediate payment of the tax for the taxable period so declared terminated and of the tax for the preceding taxable year or so much of such tax as is unpaid, whether or not the time otherwise allowed by law for filing return and paying the tax has expired; and such taxes shall thereupon become immediately due and payable. In any proceeding in court brought to enforce payment of taxes made due and payable by virtue of the provisions of this section the finding of the Commissioner, made as herein provided, whether made after notice to the taxpayer or not, shall be for all purposes presumptive evidence of the taxpayer's design.

* * *

(b) *Security for Payment.*—A taxpayer who is not in default in making any return or paying income, war-profits, or excess-profits tax under any Act of Congress may furnish to the United States, under regulations to be prescribed by the Commissioner, with the approval of the Secretary, security approved by the Commissioner that he will duly make the return next thereafter required to be filed and pay the tax next thereafter required to be paid. The Commissioner may approve and accept in like manner security for return and payment of taxes made due and payable by virtue of the provisions of this section, provided the taxpayer has paid in full all other

income, war-profits, or excess-profits taxes due from him under any Act of Congress.

(c) *Same—Exemption from Section.*—If security is approved and accepted pursuant to the provisions of this section and such further or other security with respect to the tax or taxes covered thereby is given as the Commissioner shall from time to time find necessary and require, payment of such taxes shall not be enforced by any proceedings under the provisions of this section prior to the expiration of the time otherwise allowed for paying such respective taxes.

(d) *Citizens.*—In the case of a citizen of the United States or of a possession of the United States about to depart from the United States the Commissioner may, at his discretion, waive any or all of the requirements placed on the taxpayer by this section.

(e) *Departure of Alien.*—No alien shall depart from the United States unless he first procures from the collector or agent in charge a certificate that he has complied with all the obligations imposed upon him by the income, war-profits, and excess-profits tax laws.

(f) *Addition to Tax.*—If a taxpayer violates or attempts to violate this section there shall, in addition to all other penalties, be added as part of the tax 25 per centum of the total amount of the tax or deficiency in the tax, together with interest at the rate of 6 per centum per annum from the time the tax became due.

Civil Code of California:

Sec. 1912. Loan of money [defined]. A loan of money is a contract by which one delivers a sum of money to another, and the latter agrees to return at a future time a sum equivalent to that which he borrowed. A loan for mere use is governed by the chapter on loan for use. [Enacted 1872.]